



Federal Stimulus Act's Impact on State General Fund Offsets

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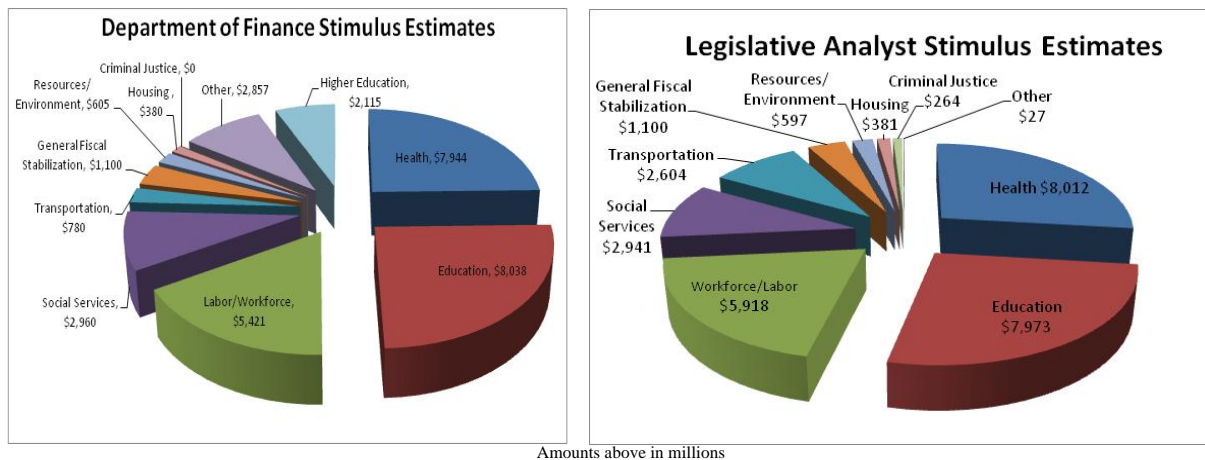
Submitted by:



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Federal Stimulus Trigger

The \$879 billion “American Recovery and Reinvestment Act” (Federal Stimulus act) will distribute about \$330 billion to states to “jumpstart our economy, create or save millions of jobs, and put a down payment on addressing long-neglected challenges...” Funding will be provided to states to help stabilize budgets and stimulate economic growth and, while the Federal Stimulus act allows for much flexibility, provisions stipulate the intent of the funding. Some funds are flexible and may supplant state funding, others must supplement state spending, and about one third of the states’ share will be allocated through federal departmental discretion or competitive grants. Initial analyses by the Department of Finance and Legislative Analyst estimate that through the fiscal year 2009-2010, the share of funds available to the state is approximately \$32.2 or \$29.8 billion respectively.



Our estimates of total stimulus dollars, based on reviews of documents from the Department of Finance, Legislative Analyst and updated federal and other materials, indicates that California will receive at least between \$34.3 and \$35.3 billion (see reconciliation matrix in Appendix B). We tracked update information provided by individual federal departments through March 13, 2009. As can be seen in the reconciliation matrix in Appendix B, the two State entities did not always agree in terms of the amounts to be recognized. Nonetheless, where one either did not include the program or may have over/under estimated the amount, the other appeared to appropriately reflect the amount. For example, the Department of Finance included no provisions for California’s allocation of Criminal Justice grants but the Legislative Analyst did include the anticipated amounts; thus, by reviewing both representations, we can ascertain the ranges of anticipated known receipts and programs involved.

Additionally, we attempted to independently verify the amounts for each of the federal programs. In the cases where federal allocations to states for individual programs became available, we compared the numbers provided by Department of Finance and Legislative Analyst. We found that, overall, figures track relatively closely with those

used in the two analyses although generally, the actual federal amounts may prove to be very slightly less than the round figures utilized by Department of Finance and Legislative Analyst.

The Department of Finance estimates that approximately \$8.2 billion of these funds would be available in fiscal years 2008-09 and 2009-10 to offset General Fund spending in four areas—health, labor and workforce development, social services, and general fiscal stabilization. While the Legislative Analyst’s Office reviewed the provisions of the trigger legislation and assessed possible federal fund offsets, it did not determine the total amount of the “General Fund offsets,” as defined in the trigger legislation. Its report on federal stimulus, released on March 10, 2009, identified its “best estimate” of offsets for those General Fund appropriations that are not associated with the Proposition 98 guarantee. At the same time, by excluding the Proposition 98 portion of General Fund appropriations from its estimate of offsets, the Analyst could underestimate the amount of the offset as defined in AB 16XXX.

Further, our research did not identify other stimulus programs that specifically suggest that the funds to be provided through the Federal Stimulus could supplant state spending. However, it is very early in the administration of the more than 75 programs involved in the Federal Stimulus and the guidance and rules for using the funds in most cases have yet to be developed by the administering federal department. Early information disseminated by the Council of State Governments indicates that of the many programs within the stimulus, those that would allow supplanting of state funds involve Medicaid and funds set out for state stabilization purposes. This tracks with the assumptions used by Department of Finance. Nonetheless, we expect in the actual application of the various programs it is not unreasonable to assume that some funding for administrative purposes or support could ultimately offset some General Fund costs, but would likely be very minor particularly in the scope of the Trigger discussion.

General Fund Offset Dollars Generated
(Amounts in Millions)

Area of Government	Department of Finance	Legislative Analyst
Health	\$6,589	\$6,424
Labor/Workforce Development	\$20	\$67
Social Services	\$509	\$370
General Fiscal Stabilization	\$1,100	\$1,100
Total	\$8,218	\$7,961

Potential Impact on Offsets by Using Different Approach or Assumptions

DOF used specific assumptions in coming to its \$8.22 billion “offset” estimate. Since none of these approaches or assumptions is defined in AB 16XXX, alternative interpretations would result in differing offset amounts. For example, the following issues may be raised:

Recognize the Impact of the Reduction in State Revenues on Prop 98 Minimum Guarantee and General Fund Expenditures

Neither DOF nor the LAO have included General Fund “offsets” that would result from reducing the Proposition 98 minimum funding guarantees due to diminished State revenues compared to those estimated when the 2009 Budget Act was enacted. As the Legislature and Governor deliberated the fiscal year 2009-10 budget during the third extraordinary session, General Fund revenue estimates available in February 2009 were used to establish the current Proposition 98 minimum guarantee amount. That estimate, in turn, was used in appropriating General Fund expenditures through June 30, 2010. Focusing on the 2009 Budget Act as enacted, the Department of Finance has excluded from its trigger estimate the implications of any subsequent events regarding General Fund revenue reductions and the potential affect on the Proposition 98 minimum guarantees. Of note, in its March 13th updated revenue forecast, “The Fiscal Outlook Under the February Budget Package,” the LAO projects an \$8 billion shortfall relative to the revenue estimates included in the 2009 Budget Act. These reduced revenues reflect the toll on California’s economy from higher unemployment, worsening GDP, lowered tax receipts and the stock market’s continued slide. As a result of the lower than expected revenue, Proposition 98 minimum guarantees for K-14 education may also be reduced by about \$3.6 billion for Fiscal Year 2009-10.

In light of the State’s deteriorating economic and revenue outlook, the LAO advises the Legislature to use additional federal dollars to offset General Fund education costs currently budgeted. Clearly, the implications of reduced revenues on Proposition 98 minimum guarantees will be critical components of the Governor’s Revised Budget in May (May Revise).

LAO states that the State can reduce its General Fund spending by roughly \$3.6 billion (spending must remain above FY 2005-06 levels) by swapping out currently budgeted General Fund dollars for new federal funds. Although the total amount of California’s share of Educational Stabilization funding does not increase, the LAO believes that the State has the option to use most, if not all, of these funds for General Fund relief. Under provisions of the Federal Stimulus act, these funds must be used to support public elementary, secondary and higher education. Consequently, if not used to offset General Fund expenditures, the funds would go to California’s K-12 and higher education institutions.

To recognize the impact of reduced revenues on Proposition 98 minimum guarantees and to apply the reduction in General Fund expenditures as an “offset” under AB16XXX

(Trigger Bill), requires a different application of key terms than those DOF employed in identifying the \$8.22 billion in General Fund offsets.

Including the estimated \$3.6 billion as an offset under the Trigger Bill requires assuming the references to “expenditure” and “offset” have a different meaning than used by DOF. Recognizing an alternative meaning allows federal funds to backfill for the reduced state General Fund expenditures. Additionally, the term “available” would need to be premised on actions expected to take place in the Governor’s May Revise budget – and, as such, could be deemed to be “available” by the Treasurer and Director of Finance by the April 1, 2009 trigger deadline.

Adding the \$3.6 billion to the offset amount, coupled with the already identified \$8.22 billion in General Fund relief, would increase the offset to \$11.82 billion. This would cause the trigger to be pulled since the offset would then exceed \$10 billion. (Also see the section “What if the trigger is pulled” later in this document.)

Add the Final Quarter of Federal Fiscal Year 2010 FMAP Funds to the “Offset”

In its calculation of the General Fund offsets available from the increased Federal Medical Assistance Percentage (FMAP) funding in the Federal Stimulus act, DOF included available funds for three quarters in state Fiscal Year 2008-09 and four quarters in the state’s 2009-10 fiscal year. In total, DOF identifies FMAP generated “offsets” equaling \$6.589 billion from October 1, 2008 through June 30, 2010 (AB 16XXX’s ending date). Moreover, the LAO estimates the offset to be \$6.371 billion through June 30, 2010, very similar to the administration’s amount.

Under the Federal Stimulus act’s FMAP provisions, approximately \$950 million in potential General Fund offsets will be available from July 1, 2010 through September 30, 2010 (the end of the federal fiscal year). As stated above, because the final federal fiscal year quarter occurs outside of AB 16XXX’s ending date (June 30, 2010), neither DOF nor LAO included any portion of the final quarter in their offset calculations.

Questions have been raised whether the State could encumber or otherwise accrue the receipt of the last quarter of FMAP funds by June 30, 2010, and thus be able to add them to the General Fund offset amount. Based on our reading of the FMAP section of the Federal Stimulus act, review of the State’s program and federal compliance provisions, experience in past Medicaid federal billing practices, and input from experts in Washington, D.C., we conclude that the funding for the final quarter of these federal funds should be counted in the State’s 2010-11 fiscal year as the related services and expenditures for the program will occur in that period.

Consequently, we find reasonable the approach used by DOF and LAO to calculate the FMAP offset.

Apply the Budget Act Line-item Vetoes to the Offset Calculation

As a final step in the 2009 Budget Act process, the Governor line-item vetoed about \$510 million in General Fund appropriation from the budgets for the University of California

(UC) and California State University (CSU) systems, in anticipation of backfilling the cuts with federal stimulus money. DOF excluded the \$510 million from its \$8.22 billion in identified offsets since the expenditures were not included in the final UC and CSU appropriations.

Because AB 16XXX's language does not define allowable expenditures as being limited to those appropriated in the 2009 Budget Act, DOF's interpretation could be questioned by stakeholders affected by not pulling the trigger. However, DOF asserts that adding the \$510 million would "double count" the benefit provided since the General Fund savings were already recognized. Further, since the final budget negotiations included agreed upon program cuts, revenue increases, anticipated federal stimulus funds, borrowing and line-item vetoes, the issue was fully deliberated. Moreover, the purpose of the line-item vetoes may have been needed to meet other constitutional or statutory requirements to balance the budget.

"What if" Scenarios if Trigger is Pulled or Not Pulled

The consequences resulting from either of the two decisions regarding the Trigger Bill (pulling trigger or not pulling trigger) are presented below.

Consequences if Trigger Is Not Pulled

Under provisions of AB 16XXX, if the Director of Finance does not notify the Joint Legislative Budget Committee and the State Controller by April 1, 2009 that the Federal Stimulus "trigger" should be pulled, certain program cuts and increases to Personal Income Tax (PIT) rates automatically take effect under Control Section 8.30 of the 2009 Budget Act. (See Appendix A for a synopsis of AB 16XXX.) A total of \$947.7 million in program cuts will take effect at the following State agencies:

Social Services

Department of Social Services, SSI/SSP grants,	\$ 267.8	million
Department of Social Services, CalWORKs grants	146.9	million
Department of Social Services, IHSS	78.0	million

Health Care

Department of Health Care Services, Optional Services	129.6	million
Department of Health Care Services, Safety Net Pool funds	54.0	million

Judicial

Judicial Branch, Trial Courts	100.0	million
Judicial Branch, New Judges	71.4	million

Universities

University of California	50.0	million
California State University	<u>50.0</u>	million

Total	<u>\$ 947.7</u>	million
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In addition, AB 3 XXX imposes a .250 percent income tax surcharge on all income levels, for a General Fund revenue gain of about \$1.829 billion in the budget year if the trigger is not pulled. The combined impact of the expenditure cuts and revenue increases is approximately \$2.78 billion.

Other Possible Consequences

We assume that the programmatic and societal consequences of the proposed cuts were fully considered by the Legislature and Governor during the 2009 Budget Act deliberations. Therefore, no analysis of the impacts on each department or program was conducted. Finally, the calculus used to craft the 2009 Budget Act through a combination of program cuts, revenue increases, borrowing and line-item vetoes is premised on not pulling the trigger unless \$10 billion in Federal Stimulus act funding is available to offset General Fund spending. Therefore, not pulling the trigger should have no effect on the State's currently approved budget.

Consequences if Trigger Is Pulled

Under provisions of AB 16XXX, if the Director of Finance notifies the Joint Legislative Budget Committee and the State Controller by April 1, 2009 that the Federal Stimulus "trigger" should be pulled, certain program cuts and increases to Personal Income Tax (PIT) rates included in Control Section 8.30 of the 2009 Budget Act would not take effect. (See Appendix A for a synopsis of AB 16XXX.)

If the trigger is pulled, PIT rate increases for all income levels would be reduced to an increase of 0.125 percent for each bracket in lieu of the 0.25 percent rate that is to take effect if the trigger is not pulled. Approximately \$1.829 billion in revenues would be lost in 2009-10 by applying the 0.125 percent increase to the PIT rate. As discussed below, this reduction in General Fund revenues could have an impact on the State's Proposition 98 minimum guarantee funding. Pulling the trigger also reinstates funding cuts from the following programs, thus increasing State costs:

Social Services

Department of Social Services, SSI/SSP grants,	\$267.8	million
Department of Social Services, CalWORKs grants	146.9	million
Department of Social Services, IHSS	78.0	million

Health Care

Department of Health Care Services, Optional Services	129.6	million
Department of Health Care Services, Safety Net Pool	54.0	million

Judicial

Judicial Branch, Trial Courts	100.0	million
Judicial Branch, New Judges	71.4	million

Universities

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Total	<u>\$947.7</u>	million
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Other Possible Consequences

Programs avoiding cuts as a result of the “trigger” being pulled would be able to provide additional services in a variety of social service, healthcare-related and judicial areas. No doubt, an unknown number of recipients of these services would benefit who would otherwise have experienced reduced services or gone without. Moreover, spending these heretofore-unavailable funds would generate both stimulative effects and produce quantitative and qualitative impacts on the economy and state revenues. But, the impacts are not easily measured.

Pulling the trigger has the effect of raising spending by nearly \$950 million and lowering General Fund income tax revenues by nearly \$1.83 billion. Taken together, these changes would reduce the General Fund balance by \$2.8 billion.

Other impacts of pulling the trigger include the implications of reduced revenues on Proposition 98 minimum guarantees. As the Proposition 98 minimum guarantee is a function of General Fund revenues, the minimum guarantee could be reduced as income tax revenues fall below the amount assumed in the February 2009 budget. If the Proposition 98 minimum guarantee were reduced, the State could lower its General Fund commitment to K-14 schools. Education Stabilization funds included in the Federal Stimulus act could then backfill for these General Funds. However, the total amount of Education Stabilization funds received by California will not change, and any funds shifted to the state General Fund would be dollar-for-dollar losses to the local education agencies (LEAs). Given the technical and complex nature of the Proposition 98 formulas, we were unable to estimate the effect on the schools’ General Fund minimum funding, under such a scenario.

Finally, pulling the trigger would generate relatively minor increases in the total Federal dollars received by California. The increase would result from Federal matching dollars associated with increased payments to public assistance recipients whose benefits would be maintained, rather than reduced, if the trigger is pulled.

Appendix A – Key Provisions of AB 16XXX (Trigger Bill)

The “Trigger Bill” requires the Treasurer and Director of Finance to do the following:

- On or before April 1, 2009, the two shall meet and confer in a public hearing regarding whether a certain amount of federal funds is forthcoming by a certain date.
- The purpose of the hearing will be to determine whether federal legislation has been enacted that “will make available” by June 30, 2010, additional federal funds that “may be used” to offset not less \$10 billion in General Fund expenditures.
- If, on or before April 1, 2009, the Treasurer and Director of Finance determine that \$10 billion or more in General Fund offsets will be made available by June 30, 2010, the Director of Finance will notify Joint Legislative Budget Committee (JLBC) and the Controller of this determination.

If the Treasurer and Director of Finance determine that \$10 billion or more of federal funds can offset General Fund expenditures by June 30, 2010, then about \$1.0 billion in program cuts and \$1.8 billion in additional taxes will be eliminated.

Appendix B – Reconciliation Matrix of Stimulus Estimates

	Total Stimulus To California--Through FY			General Fund Offsets	
	Known Amounts (In Millions)				
	Dept of Finance	Legislative Analyst		Dept of Finance	Legislative Analyst
General					
State Fiscal Stabilization					
Stabilization General Purpose	\$1,100	\$1,100		\$1,100	\$1,100
Education Fiscal Stabilization	\$4,947	\$4,875		\$0	\$0
Education					
Title 1 (Supplemental)	\$1,434	\$1,511		\$0	\$0
IDEA (B-Spc Ed + B-Preschool; C-SPED)	\$1,324	\$1,268		\$0	\$0
Child Care Develop Block Grant	\$204	\$220		\$0	\$0
Enhancing Educ Thru Tech (EETT)	\$71	\$71		\$0	\$0
McKinney-Vento Homeless	\$38	\$18		\$0	\$0
Child Nutrition Equipment	\$10	\$10		\$0	\$0
Teacher Quality Enhancement	\$10	\$0		\$0	\$0
Higher Education					
Pell Grants	\$2,095	\$500	2,6	\$0	\$0
Work Study	\$20	\$0	2,6	\$0	\$0
Health					
Temporary Increase in FMAP	\$7,730	\$7,737		\$6,589	\$6,371
Early Start	\$112	\$53		\$0	\$53
Head Start	\$102	\$188	12	\$0	\$0
Wellness & Prevention-Immunizations	not incl	\$34		\$0	\$0
Labor					
WIA--Adult	\$81	\$81	4	\$0	\$37
WIA--Youth	\$189	\$188		\$0	\$0
WIA--Dislocated Worker	\$225	\$225		\$0	\$0
Wagner-Peyser	\$46	\$35		\$0	\$0
UI--Emergency & Benefits Extension	\$3,600	\$4,299	5	\$0	\$0
UI Increased Benefits--\$25	\$1,200	\$1,000		\$0	\$0
UI Administration	\$60	\$60		\$0	\$0
Waiver of UI Loan Interest	\$20	\$30		\$20	\$30

	Total Stimulus To California--Through FY			General Fund Offsets	
	Known Amounts (In Millions)				
	Dept of Finance	Legislative Analyst	13	Dept of Finance	Legislative Analyst
Social Services					
One time Emerg Pmts--SS &SSI	\$1,510	\$1,820		\$0	\$0
SNAP--Food Stamps	\$700	\$970		\$0	\$0
SNAP Administration	\$22	\$22		\$0	\$0
CalWORKS (TANF)	\$358	\$450		\$358	\$240
Child support Enforcement Incent.	\$48	\$175		\$48	\$52
FMAP-Adoption Assist. & Foster Care	\$126	\$169		\$76	\$78
Vocational Rehabilitation	\$42	\$57		\$0	\$0
Independent Living	\$9	\$7		\$0	\$0
Elder Nutrition--Meals on Wheels	\$13	\$13		\$0	\$0
Weatherization Assistance	\$13	\$192		\$0	\$0
Community Services Block Grant	\$90	\$89		\$0	\$0
Senior Employment (SCSEP)	\$2	\$10		\$0	\$0
IDEA C-early intervention < 3 years	\$27	\$27	1	\$27	\$27
Emergency Food Assistance--TEFAP	not incl	\$12		\$0	\$0
Transportation					
Highway, Roads and Bridges Funds	\$2,600	\$2,570	7	\$0	\$0
Transit	\$0	\$34	8	\$0	\$0
Housing Programs					
Community Development Block Grants	\$11	\$11	9	\$0	\$0
HOME Funds	\$325	\$325	9	\$0	\$0
Homeless Prevention	\$44	\$44	9	\$0	\$0
Resources & Environment					
Clean Water Rev Fund	\$285	\$283	10	\$0	\$0
State Energy Programs	\$239	\$239		\$0	\$0
Energy Efficiency & Consrv Block Grant	\$56	\$56		\$0	\$0
Disel Emmissions Reduction Act	\$2	\$2		\$0	\$0
Underground Storage Tanks	not incl	\$17		\$0	\$0
Wildland Fuel Reduction Grants	\$23	\$0		\$0	\$0
Criminal Justice and Other Programs					
Crime Victims Compensation	not incl	\$264	3	\$0	\$0
Subsidized School Bonds	\$2,244	\$3,000	1,11	\$0	\$0
Tax Credit Assist. Formula Grant--Housing	\$326	\$325		\$0	\$0
Tax Credit Exchange Program-Housing	\$287	\$300	1	\$0	\$0
CA National Guard-maint & construction	not incl	\$27		\$0	\$0
Total	\$34,020	\$35,013		\$8,218	\$7,988
Other Justice programs not included	\$252	\$252		\$0	\$0
Total Amounts of ARRA Known	\$34,272	\$35,265		\$8,218	\$7,988

1. Amount does not appear in LAO calculation for ARRA receipts--amount obtained from text.
2. Benefits to be derived by UC, CSU and Community Colleges.
3. DOF includes no calculation for these funds--LAO estimate agrees with other sources.
4. Amount in General Fund offset is 15% discretionary funds from WIA programs.
5. We were unable to reconcile to LAO's total for the category in Figure 2--this amount adjusted up by \$255 to agree.
6. Amount appears in LAO text but not in Figure calculating ARRA funds available to CA.
7. DOF totals use only \$780 of CA's \$2.6 billion--To be comparable with LAO we included the total amount .
8. DOF did not include this amount in total state funds but indicated State share \$1.07 billion but will go directly to locals.
9. LAO did not specify these numbers-amounts derived from tables and text. Additional \$112 million in block grants to locals.
10. Stimulus provides capital to fund clean water projects statewide.
11. Allows the State or local governments to issue up to \$3 billion in bonds for school capital projects.
12. LAO did not specifically include Head Start--amount included here to agree with LAO Figure 2 for health.
13. Unable to reconcile LAO total--amounts in LAO's Figure 2 do not agree with Figure 12.